COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss. SUPERIOR COURT
CIVIL ACTION NO.

COMMONWEALTH OF MASSACHUSETTS, Plaintiff, v. COUNTRYWIDE FINANCIAL CORPORATION, COUNTRYWIDE HOME LOANS, INC., COUNTRYWIDE MORTGAGE VENTURES LLC, FULL SPECTRUM LENDING, INC. Defendants.	**COMPLAINT**

I. INTRODUCTION

1. The Commonwealth of Massachusetts, by and through its Attorney General, Martha Coakley, brings this enforcement action pursuant to the Massachusetts Consumer Protection Act, G.L. c. 93A, § 4, and G.L. c. 12, § 10 to require Countrywide Financial Corporation, Countrywide Home Loans, Inc., Countrywide Mortgage Ventures LLC, and Full Spectrum Lending, Inc. (collectively, "Countrywide"), to pay civil penalties, restitution and other compensation for damages arising from their unfair origination of residential mortgage loans in Massachusetts.

2. During 2006 and 2007, Countrywide was the largest lender in Massachusetts and the nation and the largest subprime lender in Massachusetts. In originating residential mortgage loans in Massachusetts from 2005 to 2007 ("loans"), Countrywide engaged in unfair loan origination practices including approving risk-layered loans that,

at times, led to predictable borrower "payment shock" -- that is, a significant increase in a borrower's payment based on changes to the calculation of a monthly payment, frequently attributable to a change in interest rate for an adjustable rate mortgage ("ARM") or the deferral of the payment of principal on interest only or Pay Option ARMs. When originating these loans, Countrywide knew or should have known that a substantial number of its borrowers could not reasonably repay these loans according to the loans' terms and that the loans would be subject to predictable delinquency and default.

3. Today, Countrywide's unfair loans are failing at tremendous rates, making the successor to its servicing operations, BAC Home Loans Servicing LP, the servicer of one of the largest portfolios of loans in Massachusetts that are in delinquency or default. Of the subprime Countrywide loans that still exist in Massachusetts, approximately 60% of them have been in some stage of delinquency or default, and many are in foreclosure, reflecting Countrywide's business model of issuing loans without regard for borrowers' ability to pay.

4. As Countrywide has been splintered apart and portions of the operations sold off to other entities, it is the borrowers, the communities, the businesses, and the citizens of this Commonwealth and nation that are left to bear the consequences of Countrywide's unfair and predatory lending practices. By this action, the Commonwealth seeks accountability and relief authorized by Massachusetts law to address these defendants' unfair lending practices.

II. JURISDICTION AND VENUE

5. The Attorney General is authorized to bring this action pursuant to G.L. c. 93A, § 4 and G.L. c. 12, § 10. This Court has jurisdiction over the subject matter of this action pursuant to G.L. c. 93A, § 4, G.L. c. 12, § 10, and G.L. c. 223A, § 3.

6. Venue is proper in Suffolk County pursuant to G.L. c. 223, § 5 and G. L. c. 93A, § 4.

III. THE PARTIES

7. The Plaintiff is the Commonwealth of Massachusetts, represented by the Attorney General, who brings this action in the public interest.

8. Defendant Countrywide Financial Corporation ("CW Financial") is a Delaware corporation with a principal place of business in Calabasas, California. On July 1, 2008, CW Financial became a wholly-owned subsidiary of Bank of America Corporation pursuant to a merger agreement dated January 11, 2008. Prior to the merger, CW Financial was a publicly traded company. CW Financial directed and controlled the origination, purchase, sale, and servicing of residential mortgage loans in Massachusetts through its wholly-owned defendant subsidiaries. CW Financial, including its top executives, were aware of the flaws, risks, and harm associated with the loan products that are the subject of this Complaint but continued to approve the origination of such products and failed to mitigate the harm to Countrywide's borrowers.

9. Defendant Countrywide Home Loans, Inc. ("CW Home Loans") is a New York corporation with a principal place of business in Calabasas, California. CW Home Loans is a wholly-owned subsidiary of CW Financial and has been registered as a foreign corporation with the Massachusetts Secretary of the Commonwealth since 1984. CW Home Loans originated loans through both a wholesale and retail channel, and was

named as the "Lender" on thousands of mortgages and notes recorded with Registries of Deeds across Massachusetts. CW Home Loans also conducted business in Massachusetts as America's Wholesale Lender and as Full Spectrum Lending. CW Home Loans held loan servicer licenses from the Massachusetts Division of Banks, numbered LS0055 and LS0056, as well as Mortgage Lender License Number ML.

10. Defendant Countrywide Mortgage Ventures LLC ("CMV") is a Delaware corporation with a principal place of business in Calabasas Hills, California. CMV was previously a wholly-owned subsidiary of CW Financial and has been registered as a foreign corporation with the Massachusetts Secretary of the Commonwealth since 2002. CMV is now an operating subsidiary of CW Financial. CMV originates loans and is named as the "Lender" on numerous mortgages recorded with the Registries of Deeds across Massachusetts. CMV has also done business in Massachusetts as Mobility Home Loans, CMV Home Loans, and Propertymortgage.com. CMV previously indicated on its website that it holds Massachusetts Mortgage Lender License Number ML 2294.

11. Defendant Full Spectrum Lending, Inc. ("Full Spectrum") was a California corporation with a principal place of business in Pasadena, California. Full Spectrum was registered as a foreign corporation with the Massachusetts Secretary of the Commonwealth from October 3, 1996 through April 28, 2006. Full Spectrum was a wholly owned subsidiary or CFC until it was merged into CHL as the Full Spectrum Lending Division in 2004. Full Spectrum is named as the "Lender" on numerous deeds recorded with the Registry of Deeds across Massachusetts.

12. Throughout this Complaint, defendant CW Financial and its defendant subsidiaries, Countrywide Home Loans, Inc., Countrywide Mortgage Ventures, LLC, and Full Spectrum Lending, Inc. are collectively referred to as "Countrywide."

IV. STATEMENT OF FACTS

A. Countrywide Maximized Profits Through the Origination of Doomed Loans.

13. From approximately 2004 through March 4, 2007, Countrywide offered and sold loans to consumers through three production channels: retail; wholesale; and correspondent lending. Countrywide's retail channel, operated primarily through CW Home Loans's Consumer Markets Division and Full Spectrum Lending Division, sold loans directly to consumers with whom it had existing relationships or consumers who it targeted through advertising for refinancing and home equity products at its retail branches. Countrywide's wholesale and correspondent lending channels, which were operated by CW Home Loans, respectively originated loans through mortgage brokers and other financial intermediaries, and purchased loans from other lending entities. Hereafter all allegations in this Complaint relate to the time period prior to March 4, 2007. The allegations do not concern loans originated following March 4, 2007, when CW Financial became subject to the supervision of the Office of Thrift Supervision. Likewise, the allegations of this Complaint do not concern loans originated by Countrywide Bank, N.A.

14. In qualifying borrowers for its loans, Countrywide reviewed some or all of its borrowers' information, including credit scores, employment, assets, income and property valuations. Among other indicia, Countrywide utilized debt-to-income ratios ("DTI ratio"), a standard metric used to assess whether a borrower could repay his or her

debts, to approve loans. Specifically, a *front-end* DTI ratio compares a borrower's monthly debts, including mortgage payment, taxes, and insurance, to a borrower's income. A *back-end* DTI ratio utilizes that same comparison but also includes monthly revolving debt, such as student loan or car payments, to the monthly debt calculation. On its website, Countrywide's successor Bank of America suggests when obtaining a mortgage to purchase a home that a borrower have a <u>maximum</u> back-end ratio of 36%. By contrast, however, for subprime loans, Countrywide routinely approved loans for borrowers with back-end DTI ratios exceeding 50%.

15. Countrywide knew or should have known at the time of origination, and arguably even before, of the likely default and delinquencies of its loans, especially in light of the detailed information that Countrywide kept on the ongoing performance of its loans. While it could, and, at times, did pinpoint such risks with relative precision, Countrywide ignored these risks as it continued to generate larger volumes of loans to maximize its own profit.

16. Countrywide's indifference to its borrowers' inability to repay its loans was magnified by its myopic quest, embarked upon in 2004, to capture 30% of the American mortgage market. To that end, Countrywide's efforts to originate an ever-increasing volume of mortgages translated into its origination of extremely risky, unfair loans, in contravention of its own underwriting guidelines and at the expense of its borrowers, communities and the public.

B. Countrywide Ignored Basic Fair Lending Principles.

17. As a lender in Massachusetts, Countrywide had and continues to have an obligation to extend a loan only where it reasonably believed a borrower had the ability to repay the loan according to the scheduled repayment terms. <u>Commonwealth v.</u>

Fremont, 452 Mass. 733, 897 N.E.2d 548 (2008). It is unfair and a violation of the Massachusetts Consumer Protection Law, G.L. c. 93A, § 2, to originate loans in such a manner that would lead predictably to a borrower's default and foreclosure, even if such loans are underwritten with the assumption that borrowers might refinance out of such loans. Id.

18. Countrywide failed to follow this basic principle of only issuing loans that it reasonably believed borrowers could repay by originating:

a. Hybrid Adjustable Rate Mortgage ("ARM") Loans that featured a fixed introductory interest rate of limited duration where Countrywide failed to qualify the borrower to repay the loan beyond the initial introductory period;

b. Interest-Only Loans featuring lower interest-only payments for limited duration for which Countrywide failed to qualify the borrower to repay scheduled payments that included the loan's principal and interest;

c. Pay-Option ARM Loans wherein Countrywide failed to qualify the borrower to repay scheduled payments that included the loan's foreseeably larger principal (due to negative amortization) and interest;

d. Stated-Income Loans wherein Countrywide failed to properly account for the borrower's ability to repay the loan in light of the borrower's actual and reasonable income; and

e. Risk-Layered Loans that combined one or more of the above features with high DTI ratios, high loan-to-value ratios exceeding 90%, and/or prepayment penalties thereby creating a loan with excessive risk layering that Countrywide knew or should have known a borrower could not repay.

19. Countrywide knew or should have known the loan origination practices set forth in the above paragraph were unfair and harmful to borrowers and the public because Countrywide knew or should have known that its loans posed an unacceptably high risk of default and foreclosure.

C. Countrywide's Loan Origination Practices Resulted in Predictable Loan Defaults and Foreclosures.

1. Countrywide's Failure to Assess a Borrower's Ability to Repay Predictably Led to Payment Shock and Default.

a. Hybrid Adjustable Rate Mortgages

20. A "hybrid" adjustable rate mortgage loan ("ARM") is a mortgage loan with a lower fixed interest rate for a short-term period, followed by interest rate increases every six months or every year up to a maximum interest rate considerably higher than (often double) the initial rate. The initial rate is sometimes referred to as a "teaser rate."

21. Countrywide had a variety of ARM loans available to borrowers. In the subprime market, however, many of the ARM loans were hybrid two-year fixed rate/twenty-eight year adjustable loans that were referred to as "2/28 loans," or three-year fixed rate/twenty-seven year adjustable loans that were referred to as "3/27 loans." Countrywide also issued five-year hybrid ARM loans to borrowers that had a fixed interest rate for five years before the interest rate began adjusting, referred to as "5/25 loans."

22. Countrywide knew borrowers could experience a significant increase in their payments resulting from scheduled increases to the interest rate associated with the borrowers' loans. This payment increase, known as "payment shock," was an expected

result of Countrywide's hybrid ARM loans but, in originating hybrid ARM loans, Countrywide only calculated the borrower's ability to repay the loan at the initial introductory monthly payments. Specifically, Countrywide only used the initial introductory lower interest rate to calculate a borrower's DTI ratio and disregarded whether the borrower could repay the loan after the interest rate began adjusting for the remaining life of the loan.

23. By way of example, a typical Countrywide 3/27 hybrid ARM loan would start with a low initial introductory interest rate for two years. One 3/27 loan originated in Massachusetts had a principal amount of $324,000 over a 30-year term at an initial interest rate of 6.15%, the initial monthly payment during the first two years was approximately $1,974. After the first three years, the initial rate of 6.15% expired, and the new interest rate could adjust up to 7.65% during the first six months of the new rate, resulting in a monthly payment of $2,277.29. The interest rate would continue to adjust every six months and two years later, with an allowed 1.5% increase every six months, the interest rate could potentially increase a total of six percentage points to 12.15%, making the monthly payment $3,262.41. Thus, within five years of origination, a borrower's monthly payments could increase by nearly 65% from the initial monthly payment.

24. Countrywide qualified its borrowers to repay a hybrid ARM loan at the initial introductory rate, typically in place only for the fixed rate period (generally two or three years) of the 30-, or 40-year mortgage.

25. Countrywide knew or should have known that failing to qualify the borrower beyond the introductory period was unfair. Further, originating hybrid ARM

loans with the expectation that borrowers could refinance out of these loans before the adjustments occurred is also unfair because, especially with respect to higher LTV loans, it unreasonably presumes and depends upon perpetual appreciation of property values.

26. Countrywide originated approximately 43,000 hybrid ARM loans in Massachusetts. Approximately 16,437 of those loans were still active as of October 2009. Of those active loans, nearly half were two-year or three-year hybrid ARM loans.

27. By October 2009, an astounding 74% of borrowers in Countrywide's active two-year hybrid ARMs were in delinquency or default and approximately 51% of borrowers in Countrywide's active three-year hybrid ARMs were in delinquency or default compared to a delinquency or default rate of only 13% for borrowers with a fixed rate loan.

b. Interest-Only Mortgages

28. A Countrywide interest-only loan allowed the borrower to make payments consisting solely of interest due (as opposed to traditional payments consisting of principal and interest) for an initial period of three, five, seven or ten years. Once that initial time period expired, the borrower was required to then make a fully-amortizing payment, or payment that included both principal and interest. Countrywide only qualified borrowers to repay the interest-only payment amounts and not the larger fully-amortizing payment that would occur after the initial time period—a time period as short as two years.

29. Countrywide also combined its interest-only feature with hybrid ARM loans, thus exposing its borrowers to multiple payment shocks. For example, Countrywide would combine a 3/27 hybrid ARM loan with a five-year interest-only

period, resulting in the borrower's monthly payment potentially increasing continually after the initial three-year period and absolutely increasing at the end of interest-only five years when the monthly payment became fully-amortizing. For example, a borrower who received a 3/27 hybrid ARM with a five-year interest only provision would experience two distinct payment shocks. First, the borrower would experience an interest rate increase at the close of the first three years of the loan when their interest rate would reset to a new rate, higher that the initial teaser rate. However, the new payment would remain an interest-only payment, with no payment toward principal. Just two years later, five years after the loan was originated, the borrower would experience a second payment shock when the payment would again reset – this time to include fully-amortized payments that included payments on the principal. Due to rate floors imposed by the terms of many of these loans, the resetting interest rate could only increase and never decrease regardless of the behavior of interest rates in the marketplace.

30. Countrywide knew or should have known that certain borrowers would not be able to afford its interest-only loans once the interest-only period ended and the payments became fully-amortizing. Countrywide exacerbated the payment shock related to its interest-only loans by combining this feature with hybrid ARM loans. Countrywide knew or should have known its origination of its short-term interest-only loan products was fundamentally unfair to Massachusetts consumers because the loans were predictably unsustainable.

c. Pay Option ARM Mortgages

31. Beginning in approximately 2003, Countrywide aggressively marketed its payment option ARM loan, known as the "Pay Option ARM." The Pay Option ARM

was classified by Countrywide as a "prime" loan product, but shares many of the risk characteristics of subprime loans, such as predictable payment shock. Like several of Countrywide's subprime loans, Countrywide failed to reasonably account for its borrowers' abilities to repay fully amortized Pay Option ARMs, leading to high default rates.

32. Countrywide's Pay Option ARM was an ARM loan that started off with an exceedingly low introductory rate—often as low as 1%—for an introductory period of one or three months. Upon the expiration of the introductory rate, the loan immediately transitioned to an ARM loan. Even though most ARM loans' interest rates adjust every six months or a year, a Pay Option ARM's interest rate adjusts every month based on the fluctuations of the corresponding index that Countrywide used to calculate the interest rate, such as the 11^{th} District Cost of Funds Index (the "COFI"), the 12 Month Treasury Average (the "MTA") or the London Inter Bank Offered Rate (the "LIBOR").

33. Although a Pay Option ARM's introductory interest rate ended after a very short period of time, the borrower's payments did not immediately change to reflect the new interest rate. Rather, under a Pay Option ARM, the borrower is given four payment options each month: (1) a minimum payment that covers none of the principal and only a part of the interest normally due each month; (2) an interest-only payment; (3) a payment that is amortized to pay off the loan in 30 years; and (4) a payment that is amortized to pay off the loan in 15 years.

34. The first option or "minimum payment" for the first 12 months is based on the introductory interest rate–the rate that is often as low as 1%–even though the actual interest rate adjusts upward after one to three months. This results in a minimum

payment that pays nothing toward the principal of the loan and only a portion of the interest that is accruing after the adjustment. The unpaid portion of the accrued interest is then added onto the principal of the loan and results in "negative amortization."

35. At the close of the first year of the loan, the borrower's "minimum" payment jumps from being calculated at 1%, or other introductory rate, to a fully-amortized payment at a new, higher interest rate. However, due to the extreme impact of such an increase on the borrower's monthly payment, Countrywide applied a cap on the adjustment, limiting the increase in payment to 7.5% each year for the first five years of the loan. At the fifth payment change or fifth year, the loan "recasts" and the required payment pursuant to the loan terms is a fully-amortized payment that includes both interest and the current principal – which typically has increased from loan inception because borrowers, in large numbers, chose a payment that caused the principal on their loan to increase through negative amortization.

36. As a consequence of negative amortization and the continual increase in the principal balance, a borrower increasingly loses equity in the home. In addition, each time a borrower makes only the minimum monthly payment, which, consistent with Countrywide's sales strategy, borrowers routinely did, it increases the magnitude of eventual payment shock when the payment becomes a fully-amortizing payment that includes both interest and principal.

37. As of October 2009, 89% of active, owner-occupied Pay Option ARMs had increased principal balances resulting from negative amortization.

38. The loan balance on a Pay Option ARM has a negative amortization cap, typically 115% of the original loan amount, meaning that if, as a result of negative

amortization, the loan balance increases to the cap, the payment is immediately recast to the fully-amortized monthly payment. At this point, the recast fully-amortized payment is based on interest and a principal balance 15% larger than the original principal balance. Countrywide knew that most borrowers making the minimum payment would be subject to recast in just three to four years, having reached the negative amortization cap of 115%, due to the addition of unpaid interest to the principal.

39. Even for borrowers that did not reach the 115% negative amortization cap and thereby avoided a recast in just three or four years, they could expect payment shock after no more than five years attributable to the required recast associated with the loan product. At which point, they would be required to pay fully-amortized payments based on the total outstanding principal on the loan with no option to make an interest only or other "minimum" payment.

40. Countrywide knew or should have known that a borrower would suffer severe payment shock, particularly once he or she was required to make fully-amortizing payments including interest and increased principal due to the negative amortization.

41. For example, Countrywide originated a Pay-Option ARM to a Massachusetts borrower that had a initial principal balance of $264,000, an initial interest rate of 1.5%, and a margin of 3.6% (with the index being based on the "Twelve Month Average" of annual yields or "12-month MTA index"). After the teaser rate expired, based on the 12-month MTA index as of the date the borrower obtained the loan, the interest rate would increase to approximately 8.55%. Assuming the borrower chose to make the minimum payment for as long as possible, the payment schedule would be approximately as follows:

a. $731.74 for the first year (or first twelve months);
b. $786.62 for the second year (or the second twelve month);
c. $845.62 for the first nine months of the third year; and
d. $2,237.64 for the last four months of the third year, and remaining 36 years.

Here, the borrower's payment substantially increased—tripled, in fact—after two and a half years. Countrywide knew that if a borrower choose to make minimum payments, which were less than the full interest and principal due, then the borrower's principal would increase by 15% due to negative amortization within two years and nine months, thus resulting in the borrower needing to pay the fully-amortized payment and suffering significant payment shock.

42. In fact, on April 4, 2006, CW Financial Chairman and Chief Executive Officer Angelo Mozilo received an e-mail stating that "72% of [Pay-Option] customers choose Minimum Payment selection in February 05, up from 60% in August 05." Mozilo responded by sending an e-mail to CW Financial Chief Operating Officer David Sambol stating "Since over 70% have opted to make the lower payment it appears that it is just a matter of time that we will be faced with much higher resets and therefore much higher delinquencies."

43. In May of 2006, Mozilo sent a similar e-mail to Sambol and Chief Financial Officer Erik Sieracki stating that "the Bank faces potential unexpected losses because higher [interest] rates will cause the loans to reset much earlier than anticipated and as a result causing mortgages to default due to the substantial increase in their payments . . . ." The next day, Mozilo wrote to Sambol and Sieracki that Pay-Option loans presented a long-term problem "unless [interest] rates are reduced dramatically from this level and there are no indications, absent another terrorist attack, that this will happen."

44. Again, in June of 2006, Mozilo flagged the significant problems with Pay Option ARM Loans in an e-mail to Sambol and others stating that due to rising interest rates, resets were going to occur sooner than scheduled, and because at least 20% of Pay-Option borrowers had FICO scores less than 700, borrowers are "going to experience a payment shock which is going to be difficult if not impossible for them to manage."

45. Despite this knowledge, which dates back to at least 2006, Countrywide continued to originate Pay-Option ARMs through 2007 and into 2008.

46. Countrywide knew or should have known that many of its borrowers could not reasonably repay Countrywide's Pay Option ARMs, and the delinquency rates reflect this. Between 2004 and October 2009, Countrywide originated or serviced more than 6,400 Pay Option ARMs in Massachusetts. Approximately 31% or 1,982 of these loans still remained active as of October 2009, and of those active loans Countrywide's own reports indicate that 50% are in default or delinquent.

d. Stated-Income Mortgages

47. Exacerbating the unfairness of its loan products, including its hybrid ARM, interest-only and Pay Option ARM loans, Countrywide routinely qualified borrowers for these loan products without reasonably considering whether borrowers could afford to repay the loans in light of their income. From 2003 through 2007, Countrywide issued an increasing number of loans that did not require the traditional supporting documentation to demonstrate income and for certain products, employment or assets. Although income is a crucial metric for purposes of assessing a borrower's ability to repay a loan, particularly for borrowers that have impaired credit or minimal assets, Countrywide failed to reasonably assess its borrowers' incomes for those risky loan products.

48. Countrywide had at least four programs in place to facilitate stated-income and low- documentation to no-documentation loans (collectively referred to as "Stated-Income Loans"). These programs included (a) "Reduced Doc;" (b) "No Ratio Loan" (referred to as NIVA); (c) "Stated Income Stated Assets" (referred to as "SISA"); and (d) "No Income No Assets" (referred to as "NINA") document criteria. None of these programs required a borrower's income to be verified. Instead, Countrywide would only require and verify the following:

a. Reduced Doc Loan: a borrower must state employment, income, and assets but only employment and assets would be verified.

b. NIVA Loan: a borrower must state employment and assets, but not income, and only employment and assets would be verified.

c. SISA loan: a borrower must state employment, income, and assets, and only employment would be verified.

d. NINA loan: a borrower did not need to state employment, income, or assets, nor would Countrywide verify any of those categories.

49. Stated-Income Loans were exceedingly prone to fraud by mortgage brokers, other Countrywide sales agents, and borrowers. Countrywide ostensibly employed a "reasonableness test" to approve these loans, which mainly consisted of Countrywide's underwriters using the salary.com website to see if the stated salary was reasonable in light of the borrower's purported employment. Countrywide's employees and mortgage brokers were aware of this test, however, and if they sought to falsify, or assist borrowers in falsifying salaries, they knew exactly how to do so by misstating the borrower's employment.

50. Countrywide knew or should have known of the prevalence of fraud associated with its Stated-Income Loans. Nonetheless, Countrywide aggressively promoted Stated-Income loans in Massachusetts and nationwide, which featured higher interest rates than other loans.

51. Had Countrywide taken steps to verify its borrowers' income, it would have had a reasonable basis to assess whether a borrower could, in fact, afford to repay the loan. By issuing loans without adequate borrower income verification and, at times, without adequate asset or employer information, Countrywide could not reasonably analyze whether its borrowers could afford to repay such loans and thus it subjected its borrowers in these loans to a substantial risk of default.

52. In Massachusetts, from 2004 to 2008, more than 24% of all Countrywide subprime loans were Stated-Income Loans. Not surprisingly, given Countrywide's widespread failure to reasonably assess its borrowers to repay such loans from the outset, significant numbers of Countrywide's subprime loans were delinquent almost from the beginning—*even before the predictable payment shock occurred*. Namely, 51% or more than 7,800 of Countrywide's subprime 2/28 and 3/27 hybrid ARMs were delinquent before the loans' interest rates ever reset, reflecting Countrywide's failure to meaningfully qualify its borrowers to repay these loans.

2. Countrywide Combined Loan Features that Increased the Riskiness of the Loans and the Predictability of Failure.

53. Countrywide frequently originated loans with several layers of risk, such as loans that combined a hybrid ARM, interest-only loan and/or Pay Option ARM with Stated Income features and/or high-DTI ratios. Countrywide also exacerbated the risk of

borrower default by combining high loan-to-value ratios and/or prepayment penalties with these loans.

54. A loan-to-value ratio, or LTV ratio, measures the amount of a loan as compared to the value of the property. Where two or more loans encumber a property the ratio is described as a "combined LTV" ratio or "CLTV" ratio. A 100% LTV or CLTV ratio means that a borrower has a loan or loans for the entire value of the property, or otherwise stated, has obtained 100% financing to purchase or refinance his or her property. Although Countrywide offered a loan with a 100% LTV, it more frequently structured 100% financed transactions such that the borrower would receive two loans with a CLTV ratio of 100%: one loan for 80% of the loan amount, and another for 20% of the loan. This loan arrangement was often referred to as an "80/20" with the secondary loan called a "piggyback loan" or a "piggy." The first loan in an 80/20 was frequently a 2/28 or 3/27 ARM. The second or 20% loan was generally a fifteen year fixed rate loan, but was amortized over thirty years, resulting in large balloon payments due at the end of fifteen years—another origination practice demonstrating that Countrywide expected borrowers to refinance rather than pay loans to term.

55. As Countrywide knew or should have known, historically a borrower's risk of default increases as the borrower's LTV ratio increases, particularly for loans with LTV or CLTV ratios above 90% ("high-LTV loans").

56. Countrywide knew that most borrowers would seek to obtain refinancing to avoid the payment shock associated with Countrywide's unfair loans, but that a borrower's abilities to obtain refinancing was dependent on his or her property value appreciating, particularly in the instance of a high-LTV loan.

57. In fact, Countrywide leadership referred to these products as "toxic." In March of 2006, Mozilo sent an e-mail to Sambol and others that the 100% LTV (or 80/20) subprime product is "the most dangerous product in existence and there can be nothing more toxic and therefore requires no deviation from guidelines be permitted irrespective of the circumstance." A month later, in an April 17, 2006 e-mail to Sambol, Mozilo remarked of Countrywide's 80/20 product: "In all my years in the business, I have never seen a more toxic prduct [sic] It's not only subordinated to the first, but the first is subprime. In addition, the FICOs are below 600, below 500 and some below 400[.] With real estate values coming down . . . the product will become increasingly worse. There has [sic] to be major changes in the program, including substantial increases in the minimum FICO ..."

58. Despite these admissions, Countrywide continued to originate toxic high-LTV subprime loans into at least 2008.

59. Notwithstanding Countrywide's awareness of its borrowers' increased risk of default and dependence on rising property values for refinancing, Countrywide often combined its risky unfair loan features, such as hybrid ARM, interest-only, and/or Pay-Option ARM loans, with a high-LTV loan. At times, Countrywide approved Pay Option ARMs paired with home equity lines of credit ("HELOC") resulting in a CLTV of 103%.

60. Countrywide further compounded the borrower's risk of default by adding prepayment penalties to its risk-layered loans. A prepayment penalty is a penalty that punishes a borrower if he or she prepays his or her loan early—typically due to refinancing the loan or selling the home—during a set time period. In Massachusetts, Countrywide's prepayment penalty lasted for a time period of one to three years, and

Countrywide charged a borrower three to six months of interest as a penalty for early payment. In certain circumstances, borrowers' penalties would be doubled if they refinanced with a different financial institution. Thus, for a homeowner with a high-LTV loan and a prepayment penalty who was facing payment shock due to Countrywide's loan features, he or she was unable to refinance without incurring a severe additional financial penalty.

61. Countrywide knew that excessive risk layering was unacceptable and thus programmed its underwriting system, referred to as "CLUES," to refer loans with excessive layers of risk to underwriters. Countrywide identified such layers of risk as, without limitation, insufficient liquid assets, high LTV, poor credit history, and/or high DTI ratios for the loan program selected. Notwithstanding this, Countrywide proceeded to originate thousands of loans in Massachusetts containing multiple layers of risk.

62. Countrywide's own review of its loan portfolio found that of the loans it originated in Massachusetts:

a. nearly one-third of what it termed "subprime" loans, and greater than one-third of hybrid ARM loans had LTV or CLTV ratios of 90% or higher, while 24% of Pay Option ARMs had similarly high LTV and CLTV ratios;

b. 30% of its "subprime" loans, 24% of hybrid ARM loans, and 64% of Pay Option ARMs also had prepayment penalties;

c. 24% of its "subprime" loans were also Stated Income Loans; and

d. a significant number of “subprime” loans, hybrid ARM loans, and Pay Option ARM loans were also originated with high-DTI ratios, that is, a DTI ratio greater than 50%.

By 2009, commensurate with the relative prevalence of risk-layering in the subprime, hybrid ARM and Pay Option ARM loan categories, 70% of all subprime loans and 62% of two-year and three-year hybrid ARMS loans were in delinquency or default, and 50% of Pay Option ARMs were in delinquency or default.

D. THE WIDESPREAD FORECLOSURES RESULTING FROM COUNTRYWIDE’S UNFAIR LENDING PRACTICES HAVE HARMED MASSACHUSETTS COMMUNITIES

63. Massachusetts cities and towns have suffered because of rippling foreclosures resulting from Countrywide’s egregious unfair origination practices. Upon information and belief, the number of foreclosures on Countrywide mortgages in Massachusetts rose from 2 in 2004, 92 in 2005, 479 in 2006, 1,344 in 2007, to 1,643 in 2008 and 1,638 in the first ten months of 2009, for a total of 5,198 foreclosures from 2004 to October of 2009.

64. The substantial number of foreclosures on Countrywide loans will continue in Massachusetts, particularly as many hybrid ARM, interest-only and Pay Option ARM loans are nearing their first payment shock through either a reset of the interest rate, or an overall recast of the loan in the case of Pay Option ARMs. As these loans adjust and recast, many more homeowners will foreseeably face default and potentially foreclosure. This predictable harm flows directly from Countrywide’s unfair loan origination.

65. Foreclosures are having a devastating impact on the Commonwealth and the nation. The Commonwealth and its cities and towns are incurring enormous costs due to Countrywide's unfair and predatory loan origination practices.

66. In particular, foreclosures lead to vacant, boarded-up, or abandoned properties, which create a haven for criminal activity, discourage social capital formation, lead to disinvestment and to steeply declining property values, which significantly diminish the tax base. Thus, the increase in foreclosure caused by Countrywide's unfair acts described in this Complaint has forced cities and towns with rapidly diminishing budgets to incur substantial law enforcement and emergency services costs to address incidents occurring in and around abandoned and foreclosed properties. Remaining residents are left to bear the costs associated with significant declining property values. These costs include providing counseling and other assistance to consumers on the verge of foreclosure; providing additional services to consumers who have lost their homes due to foreclosure; and providing increased law enforcement and emergency services in connection with incidents occurring in and around abandoned properties.

67. Foreclosures have a severe cost to homeowners, communities, neighborhoods and local governments. As of 2007, Congress estimated that each foreclosure costs local governments and taxpayers $19,000 or more. The Commonwealth and its cities and towns also have lost and continue to lose tax revenue as a result of declining property values caused by these continuing foreclosures.

68. The illegal conduct of Countrywide, once the largest lender in America, has contributed to the near-collapse of the mortgage market, with no meaningful solution in sight to address the sea of seriously impaired Countrywide mortgage assets and waves

of future defaults, foreclosures, and re-defaults due to insufficient, unsustainable loan modifications. To the extent Countrywide approved borrowers for loans they could never afford, should have never received, or that were exceedingly risky in light of the loan they could have received, it is now the borrowers themselves, their neighbors, governments and taxpayers that must struggle to address the reality created by the vast number of failed mortgages. Countrywide's unfair loan origination practices and consequent foreclosures continue to create enormous costs for the Commonwealth of Massachusetts, the nation, and its citizens.

V. CAUSES OF ACTION

COUNT ONE

As to Countrywide Financial Corporation, Countrywide Home Loans, Inc., Countrywide Mortgage Ventures LLC, and Full Spectrum Lending, Inc.

(Unfair or Deceptive Acts or Practices in Violation of G.L. c. 93A, § 2)

69. The allegations contained in paragraphs 1 – 72 of the Complaint are re-alleged and incorporated herein by reference.

70. By engaging in the loan origination practices described above, Countrywide engaged in unfair or deceptive acts or practices, in violation of G.L. c. 93A, § 2(a), and regulations promulgated thereunder pursuant to G.L. c. 93A, § 2(c). Countrywide's unfair or deceptive conduct includes, without limitation:

a. failing to reasonably assess its borrowers' abilities to repay its hybrid adjustable rate mortgage loans ("hybrid ARM loans"), including, but not limited to, failing to account for borrowers' abilities to pay beyond the introductory-rate periods in hybrid ARM loans;

b. failing to reasonably assess its borrowers' abilities to repay its interest-only loans, especially with regard to short-term interest only periods;

c. failing to reasonably assess its borrowers' abilities to repay its Pay Option adjustable rate mortgage loans ("Pay Option ARM loans"), including, but not limited to, failing to account for borrowers' abilities to pay the fully-amortizing payment in the instance of negative amortization;

d. failing to reasonably assess its borrowers' abilities to repay its loans where borrowers were not required to verify their income ("Stated Income loans");

e. failing to reasonably assess its borrowers' abilities to repay its risk-layered loans, including loans that combined predictable payment shock features such as hybrid ARM, interest-only loans and/or Pay Option ARMS; and:

   i. Stated Income loan features; or

   ii. DTI ratios at or in excess of 50%; or

   iii. a (combined) loan-to-value ratio in excess of 90%; or

   iv. prepayment penalties.

f. originating loans that contain product features that Countrywide knew or should have known required short-term refinancing to maintain an affordable monthly payment and/or avoid default or foreclosure and relying on perpetual property appreciation for borrowers to be able to refinance; and

g. originating unconscionable loans wherein Countrywide knew or should have known its borrower would be unable to repay the loan according to its scheduled repayment terms.

71. Countrywide knew or should have known that its conduct was unfair or deceptive in violation of G.L. c. 93A, § 2(a), 940 C.M.R. 3.16 and 8.06.

72. Countrywide knew or should have known that the ultimate harm of loan delinquencies and foreclosures would be borne by borrowers, communities and the public at large.

73. By letter dated October 16, 2009, the Attorney General gave Countrywide the required notice pursuant to G.L. c. 93A, § 4 of its intention to bring an action under the Consumer Protection Act.

PRAYER FOR RELIEF

WHEREFORE, the Commonwealth requests that this Court grant the following relief:

1. After trial on the merits, enter judgment in favor of the Commonwealth including restitution to consumers injured by defendants' unfair or deceptive acts or practices, civil penalties of $5,000 for each violation of chapter 93A, attorneys' fees, costs and other remedial relief under chapter 93A and other applicable statutes;
2. After trial on the merits, enter judgment in favor of the Commonwealth including appropriate permanent injunctive and equitable relief; and
3. Enter such other relief as the Court deems just.

Respectfully Submitted,

COMMONWEALTH OF
MASSACHUSETTS

MARTHA COAKLEY
ATTORNEY GENERAL

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